

## Tax

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# Tax Analysis

## Guidance issued on 2019 IIT annual filing requirements for comprehensive income

On 14 December 2019, China's Ministry of Finance and the State Taxation Administration issued guidance (Bulletin 94) on exemptions from the 2019 individual income tax (IIT) annual filing for comprehensive income, as well as a consultation draft that contains general guidance on the filing requirements.

### Background

The new IIT law, which came into effect on 1 January 2019, consolidates four categories of income from the previous system (i.e. salaries and wages, remuneration for independent services, income from authors' remuneration and income from royalties) into a single category called "comprehensive income." IIT on the comprehensive income of resident individuals is assessed annually and collected through advance payments withheld and remitted by payers on a monthly or transactional basis, with a final settlement made by the taxpayer at the time the annual declaration is filed. Under the new IIT law, 2019 is the first year for which an annual IIT filing is required for comprehensive income.

### Highlights of Bulletin 94 and draft guidance

#### 1. Purpose of IIT annual filing of comprehensive income

The purpose of an annual filing of comprehensive income is to arrive at the amount of IIT owed by a taxpayer (or any refund due) on comprehensive income derived in a tax year.

An example of an IIT calculation for comprehensive income is set forth below:

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- Total annual comprehensive income
  - Less: standard deductions (i.e. RMB 60,000)
  - Less: itemized deductions (i.e. social insurance and housing funds)
  - Less: additional itemized deductions (e.g. education, housing)
  - Less: other deductions (e.g. charitable donations)
  - § Total taxable comprehensive income
  - § Multiplied by: applicable tax rate
  - § Less: quick deduction
    - Total IIT on comprehensive income for 2019
    - Less: Total IIT advance payments for 2019
      - Final IIT on comprehensive income owed (or refunded) for 2019

## 2. Individuals required to file

Only resident individuals are required to file a 2019 IIT annual declaration for comprehensive income. A resident individual is defined as either an individual domiciled in China or a nondomiciled individual who is in China for 183 days or more in a calendar year. Therefore, a foreign national (who often would be considered a nondomiciled individual in practice) would be exempt from the 2019 IIT annual filing requirement if he/she is in China for less than 183 days in 2019.

A resident individual is exempt from the 2019 IIT annual filing requirement if:

- His/her total comprehensive income for 2019 does not exceed RMB 120,000;
- The final IIT owed for 2019 on comprehensive income does not exceed RMB 400; or
- The IIT for 2019 on comprehensive income does not exceed the total IIT advance payments for 2019, and the individual chooses to forego any overpaid IIT.

## 3. Types of comprehensive income

As noted above, comprehensive income consists of four types of income: salaries and wages, remuneration for independent services, income from authors' remuneration and income from royalties.

Income that is taxed under a category other than comprehensive income is not subject to the comprehensive income annual filing requirement. Such income includes dividends, interest, income from the transfer or leasing of property, and certain incidental income.

Certain salaries and wages (e.g. qualifying annual bonuses, severance pay, income from equity incentive plans by listed companies) may be subject to a special regime so that such income is taxed separately from other comprehensive income. Where income is subject to such special regime, it is not included in the IIT annual filing declaration for comprehensive income.

## 4. Deductions from comprehensive income

Normally a taxpayer provides to the withholding agent information related to deductions against income in order for the withholding agent to calculate the advance IIT payments to be withheld. Apart from such claimed deductions, the following deductions may be taken from comprehensive income when the taxpayer files the annual return:

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- Qualifying healthcare expenses for serious illnesses suffered by the individual or his/her spouse or minor children;
- Qualifying charitable donations; and
- Any other deductions the individual is entitled to for 2019 but was not claimed when the advance IIT payments were withheld and remitted by payers.

The tax authorities may disallow any deduction that the taxpayer cannot adequately support to the satisfaction of the tax authorities.

## 5. When, where and how to file

The 2019 IIT filing of comprehensive income must be made between 1 March and 30 June 2020. However, a nondomiciled resident individual may file earlier if he/she is no longer in China prior to 1 March 2020.

The new guidance provides the following rules to determine where to file the annual return:

- If a taxpayer files the annual return on his/her own, or engages another party (other than a withholding agent) to do the filing, the return must be filed with the tax authorities at the place where the taxpayer's employer is located;
- If a taxpayer has more than one employer, he/she may elect to file the return in the place where any of the employers is located;
- If a taxpayer is not an employee, the return must be filed in the place where the taxpayer either registers his/her household or habitually resides; and
- If a taxpayer requests that the withholding agent file the declaration, it must be filed in the place where the agent is located.

The declaration can be filed electronically via the tax authorities' website, by mail or in person at the tax authorities' office.

If a taxpayer requests a withholding agent that pays salaries or continuously pays services remuneration to file the annual declaration on the taxpayer's behalf, the agent cannot refuse. In this situation, the taxpayer must provide all the relevant information to the withholding agent in a timely manner and is responsible for the authenticity, accuracy and completeness of the information.

If a taxpayer engages a professional agent or other third party to file on his/her behalf, the taxpayer and the third party must sign an authorization letter clearly defining the rights, responsibilities and obligations of each party. The withholding agent must keep the authorization letter in accordance with relevant compliance rules.

## 6. Payments and refunds

Any IIT due may be remitted through online or in-person banking, a point of sale terminal or through services offered by non-banking institutions.

To receive a refund, a taxpayer must have a qualifying Chinese bank account. If the total comprehensive income in 2019 does not exceed RMB 60,000 and IIT advance payments have been withheld and remitted properly, a simplified online refund will be available between 1 March and 31 May 2020.

## Comments

Bulletin 94 and the consultation draft provide detailed guidance on 2019 IIT annual filing obligations for comprehensive income. Of particular interest, resident individuals may be exempt from the filing requirement if their annual comprehensive income does not exceed RMB 120,000 or if the tax due does not exceed RMB 400. This relief is in accordance with the national policy to mitigate the tax burden of middle- and low-income earners.

## *Taxpayers*

Taxpayers are responsible for the authenticity, accuracy and completeness of the information reported to the tax authorities. The Chinese tax authorities have significantly enhanced information sharing among government departments, further enabling the detection of inaccurate information. Moreover, individuals' compliance records in relation to annual filings will be included in the IIT credit system. In cases of serious violations, taxpayers potentially could be subject to a downgrading of the personal credit rating and multi-departmental joint penalties, as well as administrative penalties and late payment surcharges. Therefore, taxpayers should be fully aware of the importance of tax compliance and ensure their declarations are accurate.

The introduction of the annual IIT filing requirement for comprehensive income creates challenges for taxpayers in that filing requires tax technical knowledge and judgement, such as assessing tax residence, determining the relevant income category and deduction eligibility, collecting and managing supporting documents, and calculating taxes. The following taxpayers, in particular, may require professional assistance:

- High-net-worth individuals with diversified income: It may be difficult to determine the nature of the income and the applicable tax categories. Under current rules, different tax categories may be subject to different tax calculation methods and/or tax collection rules. This will increase the complexity of data management and tax calculations.
- Foreign employees in China: Tax residence status could change from year to year, impacting the IIT treatment and annual filing obligations. This also may be linked with IIT compliance in the individuals' home countries.

## *Withholding agents*

According to the consultation draft, withholding agents (especially employers) still play an important role in the IIT annual filing of comprehensive income. If taxpayers file on their own, withholding agents must provide them with accurate information about the income paid and IIT withheld. If taxpayers request withholding agents to file the declaration on their behalf, the withholding agents cannot refuse to do so.

Although withholding agents may be provided with filing software by the tax authorities to facilitate centralized filing for their employees, companies should have systems in place to manage their IIT withholding data. Companies also should relay information to management teams and other employees about the IIT annual filing requirements and determine which employees have requested filing on their behalf and ensure that the written authorizations are in place.

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

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